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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Price Cap Performance Review	)	
for Local Exchange Carriers;	)	CC Docket No. 94-1
Treatment of Video Dialtone	)	
Services Under Price Cap	)	
Regulation	)	

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COMMENTS

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SUMMARY

Undertaking a special inquiry in order to develop special price cap rules for video dialtone is a misguided effort. LECs face a competitive marketplace as they prepare to bring video dialtone services to the public. Given the competitive nature of the service, the Commission should establish rules which would remove VDT services from price caps and streamline regulation of VDT services.

If, however, the Commission insists on treating VDT as subject to price cap regulation, it need not impose a new price cap structure. The existing price cap plan can easily accommodate VDT. Moreover, the possibility that VDT services can be cross-subsidized by other communications services is imagined.

Under the price cap rules, the existing service band and subindicies will serve to constrain the amount by which LECs can raise prices of other interstate transport services. In addition, even if there was no service banding or subindicies within the trunking basket, the marketplace for transport services prevents LECs from offsetting VDT price decreases with rate increases from other transport services. Thus, the perceived regulatory reasons for establishing a separate VDT basket lack any substantive foundation.

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In the Matter of	)	
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Price Cap Performance Review for Local Exchange Carriers; Treatment of Video Dialtone Services Under Price Cap Regulation	)	CC Docket No. 94-1

COMMENTS

BellSouth Telecommunications, Inc. ("BellSouth") hereby submits its Comments on the Commission's Further Notice of Proposed Rulemaking in CC Docket No. 94-1 regarding the establishment of rules governing the treatment of Video Dialtone (VDT) Services under price regulation.[1]

I. INTRODUCTION

Undertaking a separate inquiry to develop special price cap rules for VDT is a misguided effort. Without question, LECs face a competitive marketplace as they prepare to bring VDT services to the public. In order to be successful, the LECs face the daunting task of competing with well-established cable systems.

Faced with a new entrant against an entrenched incumbent, the Commission typically ignores the regulation of the new entrant. The instant proceeding represents a radical departure from the Commission precedent. Here, the

[1] In the Matter of Price Cap Performance Review for Local Exchange Carriers; Treatment of Video Dialtone Services Under Price Cap Regulation, Further Notice of Proposed Rulemaking, CC Docket 94-1, FCC 95-49, released February 15, 1995. (hereinafter Notice).

incumbent cable company is subject to minimal price regulation (in comparison to LEC price cap regulation) which ceases altogether if the LEC's VDT offering is marginally successful. Nevertheless, the Commission's energies are now focused on establishing unique and apparently stringent price cap rules for VDT.

Given the competitive marketplace faced by the LECs, the Commission should establish rules that exclude VDT from price caps and streamline the regulation of VDT services. The Commission promptly followed such a course with respect to AT&T. Competition was the basis for removing AT&T's services from under its price cap plan and streamlining regulation for those services. The only characteristic considered was the competitiveness of the service with each service considered individually; irrelevant was the fact that all AT&T services are provided over an integrated network.

Were the Commission to follow a similar regulatory approach with LECs, the focus here would shift to streamlining regulation for VDT. For whatever reason, streamlining regulation for LECs competitive services is a future tense event. If the Commission insists on treating VDT as subject to price cap regulation, then the Commission must be guided by the overarching goals of price cap regulation as a whole.

A properly defined price cap regulation plan can spur investment and have salutary benefits of contributing to job creation and economic growth. The plan must include the proper incentives to promote investment and innovation. The plan should avoid imposing constraints that have the effect of diminishing LEC performance and efficiency. Baskets, service band indices, productivity offsets and sharing are all features of the LEC price cap plan that serve to sacrifice efficiency and performance considerations in favor of regulatory concerns. BellSouth has advocated, in the Commission's review of the LEC price cap plan, modifications that would improve the performance of the LEC plan and ensure that the plan would be consistent with the Commission's expansive public policy objectives. This same objective remains valid here.

For this reason, BellSouth has considerable concern with the direction that this proceeding appears to be moving. The Notice evidences an approach that a special or separate plan is warranted just because VDT is a new service. Yet, the broad review of the LEC price cap plan is still ongoing with another further notice of proposed rulemaking to be issued. Despite that much remains to be done with regard to the LEC price cap review, there is no attempt to bring this proceeding into phase with the overall LEC price cap review. If a plan that promotes efficiency and innovation is to be adopted, the Commission should not be engaged in revisiting the basic construct of the plan each time a new service becomes available. It is difficult to envision a more chilling effect on innovation than the prospect of price cap regulation rules developed on a service by service basis.

II. THE COMMISSION NEED NOT ADOPT SPECIFIC PRICE CAP RULES FOR VDT

VDT does not require a special set of price cap regulation rules. To the contrary, the existing price cap plan can easily accommodate VDT. As will be discussed below, the concerns that appear to have influenced the Commission's tentative conclusion that a separate basket should be established for VDT are baseless. The introduction of VDT should not be an excuse to impose additional regulatory restraints on an already severely limited price cap regulation plan. Instead, the Commission should commit, in the context of its ongoing review of the LEC price cap regulation plan, to continue to modify the plan to eliminate limitations that serve no regulatory purpose and which needlessly interfere with the efficiencies and incentives that price cap regulation can create.

A. A Separate Price Cap Basket For VDT Is Unnecessary

In the Notice, the Commission tentatively concluded that VDT should have a separate price cap basket. In reaching this conclusion, the Commission believes that a do not improperly subsidize VDT.[2] In addition, the Commission perceives that the competitive and technical characteristics of VDT services are not similar to any services in existing price cap baskets.[3]

The Commission's tentative conclusion is in error in a number of respects. First, from a price regulation standpoint, a separate basket would be inconsistent with a properly crafted price cap plan. The Commission has long recognized that multiple price cap baskets are a means of restricting pricing flexibility that would otherwise occur under a system of pure price regulation.[4] When the Commission established baskets, the Commission recognized that the cost of creating multiple baskets was the loss of economic efficiency that would otherwise have been possible. The justification for this result was a determination that the baskets were necessary to provide ratepayers with certain protections.

In establishing baskets, the Commission must guard against stifling the incentives that price cap regulation and its attendant pricing flexibility is intended to create. In BellSouth's view, the existing basket and banding

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[2] Notice ¶ 8.

[3] Id. ¶ 11.

[4] Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, Second Report and Order, 5 FCC Rcd 6786 at 6810, ("LEC Price Cap Order").

limitations are overly restrictive and prevent the LECs from pricing services in an economically efficient level. Even the Commission recognizes that VDT services are competitive. The LECs have no market power in the offering of these video transport services. The core concern of the Commission is that LECs may raise the prices of other interstate services to offset price decreases for VDT services. Creation of a separate price cap basket for VDT, however, would only exacerbate unnecessary inefficiencies currently present in the LEC price cap rules.

The perceived regulatory reasons for establishing a separate VDT basket lack any substantive foundation. The possibility that VDT services can be cross-subsidized by other communications services is imagined.

BellSouth has already suggested that VDT could easily be accommodated in the trunking basket (with other transport services).[5] If VDT were included in the trunking basket, there are two reasons that preclude BellSouth from engaging in the kind of pricing behavior that is at the core of the Commission's concern. First, the existing price cap rules already establish service bands and subindices that severely constrain the amount by which BellSouth can raise the prices of other interstate transport services. The simple fact of the matter is that these upward pricing constraints prevent

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[5] See BellSouth Comments in Opposition to Joint Petition for Rulemaking and Request for Establishment of a Joint Board, RM-8221, filed May 21, 1993, at 14.

BellSouth or any other price cap LEC from engaging in the pricing behavior that the Commission seeks to prevent by establishing a separate VDT basket.

Second, and even more compelling, is that even if there were no service banding or subindices within the trunking basket, the marketplace for transport services prevents BellSouth from offsetting VDT price decreases with rate increases for other transport services. Transport services included in the trunking basket are subject to effective competition. Alternative access providers have been building state-of-the-art fiber networks to compete with the LECs. These alternative networks have targeted LEC areas and customers that account for the preponderance of LEC access transport revenues. The rapidity with which these alternative networks have developed and their scope demonstrate the ease with which LEC transport services can be replaced.

Facilitating transport competition is the availability of expanded interconnection. Through expanded interconnection, LEC competitor's have access to traffic aggregation points that appear in the LEC network. Expanded interconnection will, as intended, ease market entry and spur the availability of alternatives to LEC access services.

The competitive developments of the last several years make the marketplace an effective check on LEC transport prices. In these circumstances, the LECs do not have the market power to raise the prices of access services in the trunking basket in order to cross-subsidize VDT.

Thus concerns regarding cross-subsidization have no basis in fact. While the subject of cross-subsidy has significant emotional appeal, that concern is speculative and without foundation. It can hardly be used by the Commission to support the establishment of a separate basket for VDT.

Another justification offered by the Commission for a separate VDT basket is the assumption that VDT offerings are different from other services in existing price cap baskets. In the Commission's view, where a service possesses characteristics, such as technical differences or differences in the level of competition not shared by other services, a separate price cap basket is warranted. These criteria, however, seem to overlook the efficiency losses that a separate basket brings with it and fails to balance this cost with an identified regulatory benefit.

Nevertheless, even applying these "differences" criteria, there still is no basis for a separate VDT basket. As a transport service, VDT would be included in the trunking basket. The trunking basket, as currently constituted, is not homogeneous. From a technical standpoint, the trunking basket includes services that use twisted copper pairs, carrier systems, fiber cables, coaxial cables, packet switches and tandem switches. There is nothing in the provision of VDT services that would technically single VDT out and somehow exclude it from the trunking basket or justify a separate basket.[6]

The other characteristic the Commission suggested to support a separate basket for a new service is whether the service faces a different level of competition. As discussed above, all the services included in the trunking basket face effective competition. If anything, VDT might be viewed as facing an even stronger competitive environment because the LEC is the new entrant and competing against an entrenched incumbent. In these circumstances, however, the correct regulatory response is to exclude VDT from price cap regulation all together and immediately implement streamlined regulation. In no event would the amount of competition faced for VDT services justify a separate basket for VDT.

B. There Are No Unique Implementation Issues If VDT Is Included In The Trunking Basket

The Notice identifies several implementation issues associated with bringing VDT under price cap regulation. BellSouth believes that VDT should be treated like any new service that is introduced under price cap regulation. When the Commission adopted the LEC price cap regulation plan,

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[6] There is a common denominator between VDT and other services in the trunking basket. All provide a transport function and this common characteristic is sufficient to group them in a single basket.

only a few services were exempted from the operation of the rules. All other existing services and all new services would fall within the operation of the price cap regulation plan. It is amazing that the Commission's view is that a special set of rules should be established for VDT.

The first implementation issue raised in the Notice is the productivity factor. If VDT is included in the trunking basket, the same productivity factor employed for other interstate price cap services should apply. The productivity factor for price cap regulation was established to include all interstate services on an aggregate basis. The historical time frame over which productivity was measured included the introduction of new service offerings, the expansion of certain services and the maturing of others.

This is not to suggest that the current productivity offset is correct. The appropriate productivity offset, however, is a matter still being considered in the overall context of the LEC price cap performance review. It is in that phase of the proceeding that a complete record is being developed from which the Commission can reach a reasoned decision.

If, however, the Commission errs and establishes a separate basket for VDT in this proceeding, then the only conclusion can be that there should be no productivity offset for that basket. First, a zero productivity offset would, at least, partially balance out the unnecessary performance inefficiencies that a separate basket creates. Next, as a new service, VDT uses the newest and most efficient technologies to deliver service. There is simply no basis to presume that an additional productivity hurdle can be achieved by VDT on a stand alone basis.

As a new service, there is no analysis that could possibly be performed that could purport to identify efficiency gains experienced by VDT. In a situation where it did not have a credible economic analysis of cable industry productivity, the Commission concluded that there was no recorded basis to incorporate a productivity offset in the price cap formula governing cable service rates.[7] The same conclusion would be inescapable for VDT, if a separate basket were established.

The next issue raised in the Notice relates to how VDT services should be brought within the price cap indices. VDT is a new service. As such, to treat VDT in the same way as any new service in terms of bringing the service within the price cap indices is the only approach that makes any sense. This is true regardless of whether VDT is included in the existing trunking basket or in its own basket. There is absolutely no precedent to proceed in any other manner.

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[7] Implementation of Section of the Cable Television Consumer Protection and Competition Act of 1992--Rate Regulation, 9 FCC Rcd 5760 (1994).

The Notice requests comment on whether service band indices should be established for VDT services. As recognized in the Notice, the purpose pricing bands are intended to serve are regulatory in nature--*i.e.*, to protect ratepayers from substantial and precipitous changes in service rates and to prevent the LECs from engaging in predatory pricing and other anticompetitive behavior. None of these concerns apply to VDT.

The primary concern of the Commission which is repeated throughout the Notice is cross-subsidization. As shown in these comments, BellSouth is effectively constrained from engaging in such behavior. Likewise, BellSouth does not have the market power to raise prices for VDT services. As the nondominant provider, the LEC will not be able to precipitously increase prices for its services without disastrous consequences. In these circumstances there is no valid regulatory concern that would warrant pricing bands for VDT. Because pricing bands represent another type of regulatory constraint that diminishes the efficiency and incentives associated with price cap regulation, the absence of a compelling need dictates that no pricing bands for VDT should be established.

The final implementation issue identified in the Notice is that of sharing. Specifically, the Commission asks for comments on whether the costs and revenues associated with

VDT should be included in the interstate rate of return for purposes of the sharing and low end adjustment mechanisms.

Sharing and the low end adjustment mechanisms in the price cap rules represent a vestige of rate of return regulation. As BellSouth pointed out in its comments in the LEC price cap review:

> This sharing mechanism once again ties prices to costs by retaining the central concept of rate of return regulation, _i.e._, by looking to overall earnings on a rate base to measure LEC productivity and performance. In the process, it largely destroys the incentive structure that price cap regulation was designed to provide.[8]

The Commission recently adopted an interim revision to the LEC price cap plan that incorporates a no sharing option. BellSouth is encouraged by the Commission's acknowledgement that sharing as a mechanism is detrimental to the overall objectives of a system of incentive regulation and that the goal should be to remove sharing limitations altogether.

To the extent a LEC elects a no sharing option under the revised price cap rules, the implementation issue identified in the Notice is moot. Nevertheless, the price cap rules retain two sharing options. That fact, however, should not provide an excuse for the Commission to attempt to enact a series of arbitrary cost allocation rules that

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[8] Comment of BellSouth Telecommunications, Inc., In the Matter of Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, May 9, 1994 at 6.

apply to VDT under the guise of a more precise sharing mechanism.

The sharing mechanism is grounded in rate of return/rate base regulation. The price cap rules do not determine the rate base or the manner in which the interstate rate of return is calculated. The Commission cannot use this proceeding as a means of changing those rules. As long as sharing remains a part of price regulation, then its application should be uniform across all price cap baskets on a total interstate basis.

III. CONCLUSION

In instituting this proceeding, the Commission has overlooked the incentives that a properly crafted price cap regulation plan are supposed to create. A fundamental concept is that the benefit of price caps is to provide incentives for carriers to be innovative and introduce new technologies and service applications. By having the proper incentive structure, the carrier is rewarded for making investments and taking risk.

The overall approach reflected in this Notice is not to create additional incentives but rather to put in place regulatory constraints that reduce incentives. If the Commission proceeds unabated, the consequence will be more than an ineffective price cap plan, it will cast a serious shadow over VDT. A LEC would be compelled to reassess whether VDT investment should be made and whether VDT services should be offered at all.

Respectfully submitted,

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Date: April 17, 1995

CERTIFICATE OF SERVICE

I hereby certify that I have this 17th day of April, 1995, serviced all parties to this action with a copy of the foregoing COMMENTS reference to CC Docket 94-1, by hand delivery or by placing a true and correct copy of the same in the United States Mail, postage prepaid, addressed to the parties as set forth on the attached service list.

Julia W. Spires

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